

## Stanley Fischer: Overcoming poverty in Israel

Address by Professor Stanley Fischer, Governor of the Bank of Israel, at the Globes Israel Business Conference, Tel Aviv, 5 December 2005.

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Israel's economy is experiencing fairly rapid growth, an annual rate of 4.8 percent from the third quarter of 2003 to the third quarter of 2005. This is expressed by, among other things, improved figures of employment and unemployment, particularly in the business sector, as was shown in the data issued last week by the Central Bureau of Statistics.

Against this background, and assuming that the government's macroeconomic policy will continue, the Bank of Israel published its forecasts for 2006, according to which GDP is expected to rise by 4 percent, and business-sector product by more than 5 percent. These are certainly high rates of growth.

It is important to bear in mind, however, that the current favorable situation of Israel's economy did not simply occur by chance. It is the outcome of three main factors: the first is the state of the global economy; the second is Israel's macroeconomic strategy; and the third is the security situation.

The first is external, and relates to the positive effects on Israel of the global economy, which is showing a clear growth trend. This is reflected inter alia by the expectation that the global growth rate in 2006 will be a relatively high 3.5 percent.

The main domestic economic explanation for Israel's economic situation is the macroeconomic strategy decided upon. Thus, for the last two-and-a-half years a clear strategy has been pursued of reducing the government's share in the economy, and lowering the tax burden and the government-debt/GDP ratio. Yet despite the reduction achieved in the latter, there is still a very long way to go, as the ratio of government debt to GDP in Israel is still extremely high compared to that in other advanced countries. It is clear to me that had we not adopted the approach we did, we would eventually have had to pay the price, in the form of higher rates of interest in the financial markets and lower rates of growth and employment, among other things.

At the same time the government spearheaded a series of structural reforms, such as those in the labor market, in the public sector, in the capital market, and in the ports; implemented privatization, e.g., of Bank Leumi, Discount Bank, Bezeq and El Al; and invested in infrastructures, such as in the railways. The steps already taken will continue to bear fruit in the future. But our work in these areas is far from over. The Bank of Israel is also playing its part in this strategy, mainly by carrying out an interest-rate policy that underpins price stability, according to the government's target, and supports financial stability. This strategy is essential, as it creates the conditions for sustained growth.

The great importance to economic growth of the calm in the security situation - and expectations with regard to the peace process - must not go without mention; these have a positive effect on the economy, in particular via tourism and domestic and foreign investors' desire to invest in Israel's economy.

Nevertheless, despite all the above we may not rest on our laurels. Various goals confront us, and I will refer to two of the most important ones:

The first is in the sphere of Israel's economic strategy. We are already in an election period, and at the height of the democratic process. At such a time many questions raised in the past are raised again, and it is natural that this is accompanied by uncertainty regarding what is to follow. Since the Economic Stabilization Program of the 1980s, and especially since the 1990s, Israel's economy has followed the path to openness and exposure to the global economy and towards the adoption of economic norms based on those accepted in the advanced economies. It is of great importance that uncertainty in the political arena not be allowed to become uncertainty with regard to economic strategy in the broad meaning of the term.

Clearly, Israel's economic strategy is not an end but a means to the very important objective of sustained growth. On the face of things it would seem that it is clear enough to everyone why that objective is so important, but it is worth focusing on one or two points in this regard.

Continued growth is vital to enhance the welfare of Israel's citizens, to improve Israel's ability to attract immigration, including that from the advanced countries, to boost Israel's security, and to improve its ability to tackle its social problems, and in particular, to reduce poverty.

This brings me to the second objective facing us. We must deal with social problems. This subject is important to all of us as human beings, and also as economists; after all, economics and society are two sides of the same coin.

Responsible policy towards social issues is one which acts within the framework of the strategy described above, and which does not undermine it. It will be of little avail if we achieve economic growth long term and attain a European standard of living without attending to the social issues. But we cannot handle them properly without such growth, and would even quickly increase their severity. For example, one could deal with the question of social gaps by means of drastic hikes in taxes and transfer payments, but such a policy would also have a serious adverse effect on growth, and after a few years this would lead to a situation in which we would all be more equal, but also poorer. That is no way to attract immigration; on the contrary, it would boost emigration. And that is a position we do not want to be in.

Before dealing with the social problems we should examine them realistically, as a sine qua non for formulating the appropriate policy. The problem of poverty is too complex to be viewed from only one aspect, and it must be analyzed from several aspects. For example, although here it is generally accepted to measure poverty in relative terms, and thus to consider the problem of poverty as a question of social gaps, we should be aware of other possibilities.

To illustrate: poverty can be viewed in absolute terms, i.e., in such a way that the poverty line is determined in terms of the level of real income considered the minimum required to buy a certain basket of goods, such as food, clothing and housing. If we define the poverty line of 1997 as the level of income defining poverty in absolute terms, we would get the result that the rate of poverty, using this definition, hardly changed from 1997 to 2004, and actually went down a little. It declined until 2001, and rose somewhat thereafter.

The Bank of Israel is engaged in this complex matter of measuring different aspects of poverty, and I hope that in the Bank's Annual Report for 2005, due to be published in the first quarter of 2006, we will be able to refer to the subject at greater depth, and that this will contribute to the public debate and to the formulation of policy on this issue.

An aspect of poverty seen from another angle is the identification of the population that suffers most from poverty. We know that the highest incidence of poverty is in the ultra-orthodox ("haredi") and Arab sectors of the population, mainly because of the low participation rate of haredi men and Arab women in the labor force. According to an estimate we carried out, these sectors of the population account for more than 40 percent of the poverty in Israel. This is important for purposes of adapting policy instruments so that they are effective for these groups.

Although specific steps for dealing with poverty are very important in the short run, there are other measures of equal importance for the medium and long terms, and these must not be forgone. One such is the attainment of continued growth as the basic solution to the problem of poverty. But that is not all. Another required step is a policy that will enable all Israel's citizens to realize their full potential. This would contribute to economic growth and help the more vulnerable to avoid falling into the poverty trap. In this context the following steps should be promoted: increasing the resources in the education budget allocated to the weaker strata in order to improve the ability of the next generation to achieve greater equality of opportunity; enhancing the government's system of professional retraining, with the focus on essential skills; encouragement of professional retraining by the business sector, for example by adapting the Encouragement of Capital Investment Law to focus on human capital; and extending the programs for providing adults with basic education.

It is also important to promote policy measures to deal with the problem of poverty in the short term. Such a policy should be based on the principle of providing incentives for those capable of working, giving assistance to poor workers (in such a way that will encourage them to stay in the labor market), and providing relief for those unable to work, such as the handicapped and the elderly.

The following are some examples of policy measures consistent with the above principles: the first is instituting a system of negative income tax. This is one step which the Bank of Israel supports, and which has featured in discussions held by the team headed by Yossi Bachar in which representatives of the Bank also participate. A second example is government participation in the costs connected with encouraging the weaker sections of the population to go out to work, for example, day care centers for

children, and transportation. A third example is establishing a legal and supervisory infrastructure that would encourage the institution of reverse mortgages, which would enable the elderly to obtain a monthly income flow from the apartment they own.

The Bank of Israel has been engaged in the subject of poverty for a long time, and has published position papers, policy proposals and many research papers on it. I hope that as the government's economic advisor we will be able to contribute on this matter, in two main fields: the government's social policy, and no less important, in the public debate on social problems, which are both of the highest importance. And as they are so important, we must analyze them extremely carefully, and in particular must understand that the problem of poverty cannot be resolved in the medium and long terms without persisting on the need for continued economic growth.